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REPORT OF INDEPENDENT AUDITORS ON INTERNAL CONTROL

To the Inspector General of the
Department of Health and Human Services, and
the Director of the Centers for Disease Control and Prevention and
Agency for Toxic Substances and Disease Registry

We have audited the consolidating balance sheets of the Centers for Disease Control and Prevention (CDC) and Agency for Toxic Substance and Disease Registry (ATSDR) as of September 30, 2001 and 2000 and the related consolidating statements of net costs for the fiscal years then ended and the consolidating statement of changes in net position, consolidated statement of financing, and combined statement of budgetary resources for the fiscal year ended September 30, 2001; and have issued our report thereon dated January 11, 2002. We conducted our audits in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statements*.

In planning and performing our audits, we considered CDC's internal control over financial reporting by obtaining an understanding of the agency's internal control, determined whether internal control had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin 01-02. We did not test all internal control relevant to operating objectives as broadly defined by the Federal Managers Financial Integrity Act, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

The management of the CDC/ATSDR is responsible for establishing and maintaining internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs on internal control policies and procedures. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in conformity with accounting principles generally accepted in the



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United States; and data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information. Because of inherent limitations in any internal control, errors, and irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level, the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no material weaknesses however, we noted certain matters discussed in the following paragraphs involving the internal control and its operation that we consider to be reportable conditions. However, none of the reportable conditions is believed to be a material weakness.

ANALYSIS AND DEVELOPMENT OF FINANCIAL STATEMENTS (MODIFIED REPEAT CONDITION)

The CDC/ATSDR's central accounting system is not fully integrated with the reimbursable agreements subsidiary system, and does not facilitate the preparation of the financial statements. Currently, the financial reporting system requires several adjusting journal entries and a significant number of manually intensive processes prior to reporting accurate financial statements. The amount of human effort required during the financial statement process often results in untimely reporting of financial information that supports management decision-making.

Although the CDC/ATSDR has taken significant initial steps in implementing a formal program providing for the periodic review and the preparation of the CDC/ATSDR's consolidating financial statements, quarterly reviews of consolidated financial statements did not take place in fiscal year 2001. Additionally, as discussed in this report, there are certain conditions, including controls over reimbursable agreements, grant oversight, and development of accurate overhead rates, that continue to affect the



reliability of financial information, that if not addressed will continue to hinder the financial reporting process.

Additionally, certain reconciliation processes relating to reimbursable agreements were not adequately performed on a timely basis to ensure that differences between subsidiary systems and the general ledger were properly identified, researched, and resolved and that account balances were complete and accurate.

The following factors have lead to this condition.

- The CDC/ATSDR's financial reporting system is not fully integrated with the general ledger accounting system. The CDC/ATSDR currently downloads the detailed general ledger to a Microsoft Access™ database, which contains separate tables for each individual statement. This database does not automate the financial statement compilation, but simply summarizes the amounts according to the budget activity codes. The CDC/ATSDR enters adjusting entries several times to each individual table and budget activity and the CDC/ATSDR should review each individual table to ensure appropriate postings
- Reporting requirements at the budget activity level increased the volume of the information within the reporting system. This ultimately leads to journal entries with several postings to multiple tables within the financial reporting system.
- Inadequate reconciliations relating to the reimbursable agreements throughout the year increased the effort needed to complete accurate and timely financial statements at year-end. As we noted below under our reimbursable agreements finding, the CDC/ATSDR found it necessary to reconstruct the balances of many reimbursable agreements to provide accurate financial information.

We noted that the CDC/ATSDR did implement additional United States Standard General Ledger Accounts into there general ledger system during the year, which helps reduce the additional analysis of accounts in order to compile the financial statements. Also the CDC/ATSDR automated the compilation of the balance sheet within the financial reporting system further reducing manual intervention. Staffing and management within the Financial Management Office (FMO) also began to stabilize, although pending increases in CDC funding will challenge the ability of the FMO to execute its responsibilities with the existing resources.

RECOMMENDATIONS

We recommend that the CDC/ATSDR examine its related business processes and activities, and specifically consider the following recommendations.

- Implement a formal financial reporting system that is fully integrated with the general ledger. We understand that the Department of Health and Human Services



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(DHHS) is currently evaluating agency-wide financial systems in an effort to replace the existing system for their components. Pending implementation of such a system, we believe the CDC/ATSDR continue to improve its existing processes.

- Continue to improve the training and level of personnel responsible for financial reporting and statement preparation.
- Consider implementing the dual accounting period function during the fiscal year 2002 closing. The CDC/ATSDR's current system provides the capability of maintaining two accounting periods to be open at the same time ("dual accounting period" function when, for example, fiscal year 2001 could have remained open while still accounting for all fiscal year 2002 transactions). The implementation of this feature during the 2002 year-end closing will significantly decrease the number of top-side accounting adjustments currently required and will greatly simplify accounting for beginning balances.
- Complete its on-going effort to implement a formal program providing for the periodic review of its consolidating financial statements.
- Consider the automation of the preparation of month-end financial statements.
- Develop guidelines to streamline the period-end and year-end closing process.

CONTROLS OVER GRANTS – PMS GRANT ACCOUNTING (MODIFIED REPEAT CONDITION)

The CDC/ATSDR utilizes the Payment Management System (PMS), maintained by the Division of Payment Management (DPM) as its subsidiary system to process grant advances and expenditures for the grantee community.

Currently, there is no system in place to compare financial and progress reports, which are submitted by grantees to accounting input received from the PMS on a grantee or grant specific basis to ensure consistency between grantee reports and amounts recorded in the accounting records.

Without periodic review procedures comparing grantee reports to the PMS advances and expenses, the CDC/ATSDR may be unable to determine whether

- Grantees are withdrawing funds in excess of the guidance;
- The PMS's estimates for the advances are reasonable;
- Information provided by the grantees validate the information reported by the PMS, which is a significant detect control over grant expenditures.



RECOMMENDATIONS

The CDC/ATSDR obtained contractor assistance during the fiscal year 2001 to evaluate the grant systems and control procedures, and interaction between the CDC/ATSDR and DPM for the PMS information. However, procedures to resolve this issue during the fiscal year were not fully implemented. We recommend that the CDC/ATSDR continue its improvement of grants systems and monitoring and ensure that information received from the PMS is compared/reconciled on a regular basis to information reported to CDC by grantees. In addition, CDC should perform independent financial review procedures designed to validate the integrity of data provided by the PMS.

REIMBURSABLE AGREEMENTS (MODIFIED REPEAT CONDITION)

In fiscal year 2001 the CDC/ATSDR made advances in implementing practices to reconcile reimbursable subsidiary detail records and the related General Ledger Control accounts. However, we noted that the CDC/ATSDR did not consistently perform periodic reconciliations of reimbursable agreement subsidiary records and the general ledger during fiscal year 2001. As a result at year-end, the CDC/ATSDR was again forced to undertake a labor-intensive process to reconstruct the reimbursable agreement subsidiary ledger to identify corrections that are necessary to adjust the subsidiary at an individual reimbursable agreement basis. Continuing concerns identified during the audit include the following:

- Further training and formalized policies and procedures are needed to facilitate the appropriate recording and maintenance of reimbursable agreements.
- The CDC/ATSDR relied on a manual process, which was inefficient and prone to errors to record and maintain reimbursable agreements.
- The CDC/ATSDR did not perform reconciliations of subsidiary ledgers to the general ledger on a monthly basis. In addition, the reconciliation when performed was insufficient to adequately research and resolve errors.

RECOMMENDATIONS

We recommend that the CDC/ATSDR examine its related business processes and activities, and specifically consider:

- Developing formalized policies and procedures to record and maintain reimbursable agreements. The CDC obtained contractor assistance to develop these policies and procedures, which are not yet implemented.
- Continuing current efforts to fully automate the process to ensure the timeliness of data, the development of accurate period-end cutoffs, and the development of effective, monthly reconciliation procedures.



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- Providing additional training and oversight for personnel responsible for recording and maintaining reimbursable agreements.

CONTROLS OVER GRANTS—GRANT OVERSIGHT (REPEAT CONDITION)

The CDC/ATSDR does not have a formal policy regarding minimum technical oversight requirements relating to grants. As a result, field personnel must make the ultimate determination of required grant oversight, which may not agree with top management's intentions and/or the mission of the Department of Health and Human Services (DHHS) and/or the CDC/ATSDR. Grant expense is the CDC/ATSDR's most significant expenditure which historically accounted for over 50% of total expenses. To a large extent, the execution of the operating aspects of any grant are outside the CDC/ATSDR's direct control, more indirect control procedures must be adopted to ensure that grants are appropriately executed and accounted for by the CDC/ATSDR.

In general, there are three major controls in place at the CDC/ATSDR:

- Initial screening and evaluation controls (e.g., pre-award investigations and evaluations of a general "due diligence" nature). This is the CDC/ATSDR's primary prevent control.
- Oversight procedures performed by the Grants Management Office as well as by operating/program CDC personnel (the primary detect control to ensure that the grant is being used to accomplish the purpose/mission for which it was granted).
- Single Audit Reports (the primary detect control to ensure that grant expenditures are made in accordance with fiscal and budgetary requirements).

RECOMMENDATIONS

We continue to be concerned with certain aspects of the CDC/ATSDR's operational oversight over grants and believe the CDC/ATSDR should consider the following.

- Issue CDC/ATSDR level guidance on grant oversight policy.
- Develop specific guidance for different types of grants based on the nature of different grants issued by the CDC/ATSDR.
- Consider the appropriateness of delegating the development of oversight policy to lower levels within the CDC/ATSDR (e.g., Centers and Programs). If delegation is determined to be appropriate, the proposed policy should require formalized approval by CDC/ATSDR's top management.
- Consider the development of a more detailed guidance for the grant approval process.



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- Ensure that a mechanism is in place to periodically evaluate the appropriateness of specific oversight procedures being performed for each grant and, as needed, change the required oversight procedures.

We understand that the CDC/ATSDR is addressing the grant oversight issue and is in the process of developing revised guidance. We have been informed that revised guidance will be available during fiscal year 2002.

* * * * *

In addition, we considered the CDC/ATSDR's internal control over Required Supplementary Information by obtaining an understanding of its internal control, determined whether this internal control had been placed in operation, assessed control risk, and performed tests of controls as required by OMB Bulletin No. 01-02 and not to provide assurance on this internal control. Accordingly, we do not provide an opinion on such controls.

In addition, with respect to internal control related to performance measures reported in the Management's Discussion and Analysis (MD&A), we obtained an understanding of the design of significant internal control relating to the existence and completeness assertions and determined whether they have been placed in operation, as required by OMB Bulletin 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

We noted other matters involving internal control over financial reporting, which we have reported to Management in a separate letter dated January 11, 2002.

This report is intended solely for the information and use of the management of the CDC/ATSDR and the Department of Health and Human Services, OMB, and Congress; and is not intended to be and should not be used by anyone other than these specified parties.

Ernst & Young LLP

January 11, 2002



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REPORT OF INDEPENDENT AUDITORS ON COMPLIANCE WITH LAWS AND REGULATIONS

To the Inspector General of the
Department of Health and Human Services, and
the Director of the Center for Disease Control and Prevention and
Agency for Toxic Substance and Disease Registry

We have audited the consolidating balance sheets of the Centers for Disease Control and Prevention (CDC) and Agency for Toxic Substance and Disease Registry (ATSDR) as of September 30, 2001, and 2000, and the related consolidating statements of net costs for the fiscal years then ended, and the consolidating statement of changes in net position, consolidated statement of financing and the combined statement of budgeting resources for the fiscal year ended September 30, 2001; and have issued our report thereon dated January 11, 2002. We conducted our audits in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statements*.

The management of the CDC/ATSDR is responsible for complying with laws and regulations applicable to the CDC/ATSDR. As part of obtaining reasonable assurance about whether the CDC/ATSDR's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin 01-02, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA). We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to the CDC/ATSDR. We caution that noncompliance may occur and not be detected by the tests performed and that such testing may not be sufficient for other purposes.

The results of our tests of compliance disclosed no instances of noncompliance with other laws and regulations discussed in the preceding paragraph exclusive of FFMIA that are required to be reported under *Government Auditing Standards* or OMB Bulletin 01-02.



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At the request of the Office of Inspector General, Department of Health and Human Services, we performed test of compliance to determine whether the CDC/ATSDR's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

The results of our tests disclosed no instances in which the CDC/ATSDR's financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

This report is intended solely for the information and use of the management of the CDC/ATSDR and the Department of Health and Human Services, OMB, and Congress; and is not intended to be and should not be used by anyone other than these specified parties.

Ernst & Young LLP

January 11, 2002



DEPARTMENT OF HEALTH & HUMAN SERVICES

Public Health Service

Centers for Disease Control
and Prevention (CDC)
Atlanta, GA 30033

February 12, 2002

Mr. Dan Murrin
Ernst & Young, LLP
1225 Connecticut Avenue, NW
Washington, D.C. 20036

Dear Mr. Murrin:

We have reviewed the recommendations included in the Report of Independent Auditors on Internal Control and the related Management Letter for the fiscal year ending September 30, 2001. CDC and ATSDR concur with the recommendations, and we are committed to resolving the audit issues. While the internal control report indicates that much work remains to be done, we are encouraged to see that some improvements were noted. We value the insight provided by our independent auditors, and we will make every reasonable effort to implement the recommendations.

Presently, our efforts to achieve sustained improvements are focused on two key areas: modernization of our accounting system, and upgrading the knowledge and skills of our financial staff. Our accounting system has remained much the same over the last decade. Because we fully understand that the accounting system is critical to our mission success, we have devoted substantial resources to improving our system. We are presently engaged as an active partner in the HHS initiative to implement a uniform financial management system. Concurrently, we are continuing to upgrade our existing system through such efforts as updating our system tables, automating our reimbursable billings, and completing our indirect cost allocation methodology.

Although we realize that a modern, responsive system is important, we also know that a skilled workforce is necessary for our overall success. During the last 12 months, we have significantly improved our management structure over accounting operations, and we are providing significant new opportunities for staff training and certification.

Recent events have placed renewed attention on CDC's programs, and our budgets have grown substantially. In response, we are making significant new investments in our financial system and in our staff. During the year ahead, we will continue our efforts to implement the audit recommendations and accomplish the many other financial management objectives that are critical to our mission.

Sincerely yours,

A handwritten signature in blue ink that reads "W. Gimson".

William Gimson
Associate Director for Budget and Finance
Director, Financial Management Office

